

For What It’s Worth: Avoiding “Tracking-Error Regret”

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One way that many investors measure financial success is by comparing their returns against popular benchmarks like the S&P 500 Index. It can be comforting to know how your investments compare to others … but there’s a catch. If you are comparing apples to oranges, the results can misinform rather than enlighten your decision-making, knocking you off-course from the very success you’re seeking to achieve. The financial industry has a term for this: **tracking-error regret**. One of our key roles as your advisor is helping you recognize tracking-error regret, and avoid succumbing to it.

**Tracking-Error Regret: Cause and Effect**

Tracking-error regret occurs when your carefully designed investment portfolio underperforms popular market benchmarks. For example, it’s not uncommon to see popular headlines like these in the financial press:

*“The S&P 500 is up 19% year to date!”*

*“International stocks offer double-digit returns in Q2!”*

*“Top variable annuities deliver 15%+ performance in 2012!”*

If your own portfolio’s growth seems anemic in comparison, you may regret the decisions you’ve made and wonder if you’d best make some changes to go after that greener-looking grass. Before you switch gears, ask yourself: Are you using the right gauge for the measurement? The above figures may be accurately reported, but what do they really mean to you and your wealth?

**How Do You Measure Financial Success?**

To us, financial success isn’t defined by how closely your returns happen to match a common benchmark. Instead, it’s about you and yours. On those terms, financial success happens when …

1. You and your family have enough wealth to achieve or sustain your desired lifestyle according to your personal goals.
2. You are able to focus the majority of your time and energy on doing the things you enjoy with the people you love, instead of worrying about financial headlines.

We achieve this measure of success in several ways. The general rule of thumb is to concentrate on actions you can expect to control and avoid being entangled by those you cannot.

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| **Investment Management** | **Entangling Activities** |
| Minimizing investment costs | Hyperactive (expensive) trading |
| Forming a personalized investment plan | Second-guessing your carefully laid plans |
| Building and maintaining a customized portfolio that reflects that plan | Trading based on reactions to outside events |
| ***Measuring success according to whether you are on track to achieve your personal goals*** | ***Assuming failure if your portfolio doesn’t always track a common benchmark*** |

**Investing as a Personal Journey**

The final point in the table above gets to the heart of why it’s critical to avoid tracking error regret. To offer an analogy, imagine you decide to take a cross-country journey from Miami to Los Angeles – except, en route, you want to visit every state that begins with the letter “A.” Working with a professional travel agent, you spend hours charting out the best schedule at the most reasonable prices to achieve your personal goal of adding Alabama, Alaska, Arizona and Arkansas to your itinerary.

You’re all set to buy the tickets. Out of curiosity, you visit one of the popular discount travel sites and you notice they’re running a special on flights between Miami and L.A. *for half of what you’re about to spend.*

In this scenario, you’d probably quickly recognize that the popular site’s offer, while ostensibly a much better deal, fails to reflect your personal goals. With only a minor twinge of regret, you’d probably stick to the plans you’d made.

Think of your custom-built portfolio in the same way. Its highest purpose is not to slavishly track a common index, so it should come as no major surprise when your portfolio and its components periodically deviate from their closest benchmarks. Your portfolio should instead be designed for – and measured against – a far greater purpose: You and your desired destinations. If you ask us, that’s the only way to roll.